HARRY S. HILLS
KENNETH E. ROTH

IBLA 80-135, 80-136 Decided July 11, 1980

Appeals from decisions of the New Mexico State Office, Bureau of Lan Management, rejecting simultaneous oil and gas lease offers NM-A 36984 (and NM 37789.

Reversed in part, decisions suspended, hearing ordered.

1. Oil and Gas Leases: Applications: Drawings -- Oil and Gas Leases: Applications: Filing -- Oil and Gas Leases: Applications: Sole Party in Interest

   Where a leasing service company's client wins a Federal oil and gas lease at a drawing in which the leasing service and its officer participate, the mere participation of the company and the officer in the same filing, without anything more to create an interest in them in the client's lease, does not constitute a violation of the regulations which should be charged against the client.

2. Oil and Gas Leases: Applications: Drawings -- Oil and Gas Leases: Applications: Sole Party in Interest -- Rules of Practice: Hearings

   A reference in a letter to the Bureau of Land Management from the winning drawee in a simultaneous oil and gas lease filing to "majority owners" of the lease, by itself is not sufficient to show there were undisclosed parties in interest at the time the

offer was filed, but it would ordinarily warrant further investigation. Where a hearing is ordered on other issues to determine if there was a violation of the regulations in the filing, evidence should also be presented on this issue to explain the meaning of the reference and to show whether someone other than the offeror had an interest in the offer at the time it was filed.

3. Contracts: Construction and Operation: Generally -- Hearings -- Oil and Gas Leases: Applications: Drawings -- Oil and Gas Leases: Applications: Filing -- Oil and Gas Leases: Applications: Sole Party in Interest -- Rules of Practice: Hearings

A fact finding hearing is ordered by the Board of Land Appeals to determine whether there has been a violation of the regulations requiring disclosure of other parties in interest and prohibiting against multiple filings in simultaneous oil and gas lease filings by the contractual arrangement of Eden Capital Corporation and its clientele where there are ambiguities in the complex contract which provides for a preliminary division of lease obligations and proceeds and establishment of a lease escrow fund to protect funds promised to the client if the client exercises an option by which Eden will buy all leases in a particular lease program subscribed to by the client, and the meaning of the contract terms can best be understood in light of facts demonstrating its implementation by the contracting parties and the practical application they and other clients of Eden have given to the terms.

APPEARANCES: James T. Waring, Esq., Kaufman and Waring, P.C., San Diego, California, for appellants; Doris N. Sterkel, pro se.

OPINION BY ADMINISTRATIVE JUDGE THOMPSON

The simultaneous noncompetitive drawing entry card (DEC) oil and gas lease offer submitted by Harry S. Hills was drawn with the first priority in the May 1979 drawing for parcel NM-759 (serial No. NM-A 36984 (OK)) in the New Mexico State Office, Bureau of Land

Management (BLM). Similarly, an offer submitted by Kenneth E. Roth was drawn with first priority in the July 1979 drawing, in the same BLM offic for parcel NM-905 (serial No. NM 37789).

BLM requested additional proof regarding appellants' offers. From th additional evidence provided, BLM deduced that Harry S. Hills and Kenneth E. Roth had entered into agreements with Eden Capital Corporation on October 23, and November 14, 1978, respectively. BLM asserted that the individual agreements incorporated by reference an offering memorandum, which stated in part that:

> When the client sells a lease acquired during his participation in the program, the proceeds from the sale of that lease will also be deposited into the Lease Sales Escrow Account. * * * If the client disposes of his interest in a lease in any manner other than by sale 49% of any consideration received by the client shall be assigned to Eden.

BLM concluded that: "From the offering memorandum we have established th Eden Capital Corporation has an interest in each client's lease whether o not the `put option' is exercised. Eden Capital Corporation has overall control of all correspondence received from the sale of the leases." By decisions dated June 1, 1979, and July 27, 1979, BLM decided that since Eden Capital Corporation was to participate in the proceeds derived from appellants' leases, if issued, compliance with 43 CFR 3102.7 was mandator In addition, BLM in examining their records found entry cards filed for t same parcels by Eden Capital Corporation and Peter L. Edelmuth, president and sole stockholder of the Corporation. BLM determined that the filing entry cards for these parcels by appellants, Eden Capital Corporation, ar Edelmuth, gave them a greater probability of successfully obtaining a lea or an interest therein and therefore put them in violation of the regulation, 43 CFR 3112.5-2. Because the same issues are involved in eac appeal and the statements of reasons are similar, these appeals have been consolidated for decision. 1/

On appeal to this Board appellants assert that:

> The Put Option as provided for in the Eden program is an election, exercisable solely by the subscriber, to sell to Eden, for the sum of $5500, an undivided 49% interest in any lease acquired by the client. The key element of the Put Option is that the client has the total control

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1/ Doris N. Sterkel, as the No. 2 drawee for the parcel won by appellant Hills, has filed an appearance in that case requesting that BLM's decisio be upheld.

and discretion to decide whether or not to exercise the option.

Secondly, appellants contend that the Eden Capital Corporation memorandum which is incorporated into the clients' agreement with the Corporation, shows that Eden Capital Corporation has no claim to any interest in the leases unless the client elects to exercise the "Put Option."

[1] We address first that part of the BLM decisions finding that the filing of DEC's by Eden Capital Corporation and by its president for the same parcels as Eden's clients constituted a violation of the regulations. A similar issue has been considered by this Board in a decision involving a different leasing service company. In Ervin J. Powers, 45 IBLA 186 (1980), a majority of the Board ruled that the mere participation of the leasing service company or its officer in the same filing, without anything more to create an interest, did not constitute a violation of the regulations which should be charged against the client whose offer had drawn first priority. 2/ The decisions are reversed in part only on this issue.

[2] The next issue concerns only the Harry S. Hills case. The BLM decision referred to a letter dated October 3, 1979, in the lease offer file wherein Hills stated that the "majority owners" of the lease have planned a well within the immediate future. BLM indicated that this reference implied there are other parties in interest in the lease. The statement is not sufficient by itself to show that there were undisclosed parties in interest at the time of the filing of the lease offer, which is the crucial time. 43 CFR 3100.0-5(b). However, such a statement would ordinarily warrant our recommending that BLM initiate an investigation through appropriate channels to ascertain whether there was a violation of the regulation requiring disclosure of other parties in interest, 43 CFR 3102.7, and the regulation prohibiting the filing of multiple offers in a drawing, 43 CFR 3112.5-2. As our discussion, infra, will disclose, we are ordering a hearing in these cases to establish the facts regarding the implementation of Eden's contract with its clients. Therefore, the hearing should also address the issue raised by the letter of October 3, 1979, and evidence should be presented to explain the letter and, specifically, to show whether someone other than the offeror had an interest in the offer at the time it was filed.

[3] The difficult issue in these cases is whether the agreement between Eden and its clients creates an interest in Eden in the offers which was not disclosed when the offers were filed, and whether there were multiple filings forbidden by the regulations. The agreement in

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2/ Judge Thompson dissented in Powers and adheres to her views, but is bound to follow the majority position.

these cases is reflected by the specific investment contract between Eden and each of its clients involved in these two appeals, together with Eden "Offering Memorandum," which is its advertising brochure or prospectus, setting forth the conditions, procedures, and terms of its arrangements with its clients. Among other provisions, the "Memorandum" allows the client who subscribes to specific lease service filing programs with Eden to sell to Eden, for the sum of $5,500, an undivided 49 percent interest "in all leases acquired during the term of the program" (Memorandum, p. 7

The mere fact a leasing service company by agreement with its clients creates an option exercisable solely at the discretion of the client to purchase an interest in a lease or leases won by the client in a BLM simultaneous filing procedure does not create an interest in the company violative of the disclosure of parties regulation, 43 CFR 3102.7, and the prohibition against multiple filings, 43 CFR 3112.5-2. E.g., Virginia L. Jones, 34 IBLA 188 (1978); D. E. Pack, 30 IBLA 166 (1977); Harry L. Matthews, 29 IBLA 240 (1977); R. M. Burton, 4 IBLA 229 (1972).

The problem is whether this general rule is applicable to the particular facts of the leasing arrangement by Eden with its clients. As defined by the regulations, at 43 CFR 3100.0-5(b), an "interest" includes any "claim or any prospective or future claim to an advantage or benefit from a lease, and any participation or any defined or undefined share in any increments, issues, or profits which may be derived from or which may accrue in any manner from the lease based upon or pursuant to any agreement or understanding existing at the time when the offer is filed." The memorandum of Eden's agreement with its clients is complex in comparison with contracts between leasing service companies and their clients previously examined by this Board where the terms of the option with the client and other terms were straightforward and unambiguous. Unfortunately there are ambiguities in the contract relative to our inquiry here as to whether Eden has an interest in the offers as defined by the regulation quoted above.

It is true, as appellants contend, that the BLM decisions took several provisions out of context. We do not find that the contract provision concerning control of correspondence (Memorandum p. 3) is a basis for showing that Eden has an interest in the lease. More difficult to understand, however, is the other provision referred to in part by the BLM decision and found at page 8 of the memorandum. Appellants have explained that the State of California has required Eden to establish a special Lease Sales Escrow Account (LSEA) for clients participating in Eden's program. The purpose of this account is to assure that if a client exercises the "Put-Option" available to it in its discretion, funds will be immediately available to the client for Eden's promised payment of $5,500. The client is entitled to exercise the option within a 2-year period from the time of the client's termination of the leasing program. A preliminary 49/51

percent division of lease sale proceeds and rental obligations is made ar
funds are channeled through the escrow account. The memorandum provides
for the disposition of the funds and the obligations of the parties under
the arrangement. Basically, the accounting procedure appears to do as
appellants contend, namely, to assure a deposit of $5,500 in the event th
client exercises the option. It also appears to provide a means by which
Eden is also assured credit for the 49 percent of advance rentals paid by
it as agreed by the preliminary division until the option is exercised.
Several of the salient provisions of the memorandum concerning the escrow
account and the option are set forth in the footnote. 3/

3/ The memorandum at p. 8 provides that:

"If the client elects not to exercise the Put-Option, Eden will not b
entitled to the 49% received by way of preliminary division upon the sale
of the lease, and therefore Eden will not be responsible for the 49% rent
payment. In this event, Eden will be entitled to a credit for any rental
actually paid, against Eden's obligation to refund the 49% preliminary
distribution to the client. No interest shall be paid on any of the abov
sums.

"If the client disposes of his interest in a lease in any manner othe
than by sale, 49% of any consideration received by the client shall be
assigned to Eden. In the event such a disposition by the client is not f
full and adequate consideration, Eden's liability shall be reduced by 49%
of the fair market value of the lease at the time of exercise of the Put.
In all cases the client will retain either an overriding royalty interest
or production payment, or similar variation when he sells his lease. Suc
an interest will also be subject to disposition in the same manner as the
underlying lease itself."

The memorandum further provides at p. 9:

"* * * As previously noted, the client has until the last day of the
third year to decide whether or not to exercise. If the client elects no
to exercise the Put-Option even though he has until day 365 of year 3, Ed
would not be entitled to the 49% it received upon the preliminary divisio
of lease sale proceeds immediately following the sale of an acquired leas
(this is because Eden becomes entitled to the 49%, in exchange for the
Put-Option payment, only when the option is actually exercised).

"If the option is not exercised, Eden shall have no right to the 49%
interest, and the client shall be entitled to all of the lease sale
proceeds. Thus, should the client elect not to exercise the option prior
to the natural expiration of the option period, Eden shall refund to the
client any 49% interest which has been paid to Eden upon the preliminary
division of the lease sale proceeds following the sale of the lease, up t
the full amount of the Put-Option payment which Eden initially deposited
into the LSEA upon the client's subscription to a program unit.

The nature of the option here, the time within which it may be exercised, and the escrow accounting method is novel. Appellant emphasiz that the client has complete discretion to exercise the option and thus Eden has no interest in the offer. If there were no other questions rais here, we would agree with that conclusion. However, the terms of the memorandum agreement are somewhat confusing when we try to analyze them, we must, to see if any interest has been created in Eden. Because of ambiguities in the memorandum, we cannot find with certainty at this time that Eden does not have an interest, as defined in the regulations. The full effect and meaning of the contract arrangement can best be understoo in light of facts demonstrating its implementation by the contracting parties and the practical application they and other clients of Eden have given to the terms. For this reason, we are ordering a fact-finding hearing pursuant to 43 CFR 4.415 before an Administrative Law Judge who will make a recommended decision to this Board. We request that copies o his recommended decision be served upon all parties so that they may file any exceptions, objections, or comments to this Board, with copies to the other adverse parties.

The basic issue is whether the agreement between Eden and its clients as understood and implemented by them, establishes that Eden had any interest in the lease offers at the time they were filed. This may inclu the right to receive interest on funds in the LSEA derived from a sale of the lease, including a sale to Eden by the client's exercise of the optio All facts which have any relevance to the basic issue should be presented at the hearing. We expressly request a factual inquiry into how Eden operates the LSEA. This includes, but is not limited to, the following questions:

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fn. 3 (continued)

"The client is completely secure in this arrangement, because at all times until the client either elects to exercise the option or elects not to exercise the option, there will be the full amount of the Put-Option payment ($5,500) on deposit in the Lease Sales Escrow Account. If the client elects to exercise the option, he will immediately be paid the ful amount of the Put-Option payment from the LSEA, the 49%-51% division already having occurred upon the sale of a lease prior to the exercise of the option. On the other hand, if the client elects not to exercise the option, Eden will not be entitled to the 49% received by way of prelimina distribution. To reimburse the value of this 49% interest to the non-exercising client, the value of that 49% interest will be immediately paid to the client out of the $5,500 which has been originally deposited the LSEA."

1. Is there one LSEA into which all of Eden's clients' escrow funds are channeled or is there a separate account for each client?

2. Are all lease sale proceeds channeled through the LSEA regardless of whether the client has (a) exercised the Put-Option; (b) formally notified Eden that the Put-Option will not be exercised; or (c) done nothing?

3. If, before notification of the client's decision not to exercise the Put-Option, the client personally sells the lease to another party, d the proceeds of the sale go through the LSEA?

4. At what point in time may a client determine not to exercise the Put-Option? Can he do it at any time during his participation in the program?

5. What are the arrangements for the earning and disbursement of interest on all of the LSEA funds? Are there any circumstances under whi Eden would obtain interest on funds (including interest on interest) from sale proceeds, including the $5,500 it would pay if the option is exercised?

6. What are the accounting arrangements for Eden's share of a preliminary division? Is its share placed in escrow? Does Eden obtain interest on it? If the client declines to exercise the option is any interest Eden has obtained paid to the client?

7. If a client determines not to exercise the Put-Option after a sal in excess of $12,000, assuming such monies have been channeled through th LSEA and the preliminary 49/51 percent division has been made, what happe to the excess amounts (over $5,500) in Eden's control?

At the hearing the appellants will have the burden of proof to show that the contractual arrangement with Eden does not constitute a violation of the regulations. The decisions below will be suspended pending the ultimate determination by this Board after the hearing.

Therefore, pursuant to the authority delegated to the Board of Land Appeals by the Secretary of the Interior, 43 CFR 4.1, the decisions appealed from are reversed in part and suspended, and the cases are referred to the Hearings Division of this Department for

assignment of an Administrative Law Judge to conduct a hearing in accordance with this decision.

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Joan B. Thompson
Administrative Judge

We concur:

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James L. Burski
Administrative Judge

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Edward W. Stuebing
Administrative Judge